

## **SECTION II**

### **OVERVIEW OF THE LIHTC PROGRAM**

## SECTION II – OVERVIEW OF THE LIHTC PROGRAM

---

### Part 200 :: Background of the LIHTC Program

---

In 1986, Congress enacted the Low Income Housing Tax Credit Program (the “LIHTC Program”) to provide incentives for the investment of private equity capital in the development of affordable rental housing for persons of low and moderate incomes. The LIHTC Program reduces the federal tax liability of project owners in exchange for the acquisition, rehabilitation, or construction of affordable rental housing units that will remain income and rent restricted over a long period. The amount of tax credit allocated is based on the number of qualified low-income units that meet federal rent and income targeting requirements.

The LIHTC Program is authorized and governed by Section 42 of the Internal Revenue Code of 1986, as amended (the “Code”). MSHDA is the designated “housing credit agency” to allocate and administer tax credits for the entire state of Michigan. For additional information regarding responsibilities, see [Section III \(Responsibilities\)](#). For additional information regarding LIHTC Program legislation and regulations, see [Part 260 \(Major Regulations and Legislations Impacting LIHTC Compliance Monitoring\)](#).

---

### Part 205 :: Tax Credit Overview

---

The LIHTC Program fosters the development of affordable rental housing by establishing a mechanism through which investors provide equity and commit to restricting the rent of certain housing units. The equity funds are used to pay for part of the project development costs. The equity comes into the project from investors as a contribution to the legal entity that owns the project (the “owner”). This entity is typically a limited partnership or a limited liability company all of which are legal entity forms that allow the benefit of the tax credits to flow through to the investors. Investors, in turn, use the credit to offset their income tax liability.

Credit can be claimed on an annual basis for 10 years; however, the equity funds are usually contributed during construction or soon after the completion of the project. The price paid for the credit is determined by the timing of the payments into the project as agreed upon by its investors. The balance of the project costs are paid with conventional mortgage financing, private contributions, or other government sources, such as bond financing, HOME funds, and Rural Housing Services loans. The trade-off for receiving tax credits is that the owner must agree that the housing units receiving credit will be restricted to low-income households for a specific period of time and that the rents for these units be capped, following a fixed formula. However, because a large portion of the cost of the project has been paid from equity, a project is designed so that the restricted rents are sufficient to pay the operational costs and mortgage debt on the property. For additional information regarding the LIHTC Program, see [Section IV \(LIHTC Allocation Basics\)](#).

---

**Part 210 :: Amount of Credit Available**

---

The amount of credit available is based on the number of residents in Michigan. For the year 2002, \$1.75 per person is the amount of credit allocated to each state. In certain cases, a state may increase its available credit by using unallocated or returned credit from a prior year, or by using credit authority originally allocated to other states that failed to use all their credit authority (called the National Pool credit).

---

**Part 215 :: Qualified Allocation Plan**

---

To receive tax credits, an owner must apply to the state-allocating agency (MSHDA) and be awarded a reservation or an allocation of the state's available credit. Each state's Qualified Allocation Plan (QAP) establishes the guidelines and procedures for the acceptance, scoring, and competitive ranking of applications and for the administration of the LIHTC Program. The Michigan QAP is developed to be relevant to housing needs and be consistent with housing priorities in the State of Michigan and is approved by the Governor. Portions of the total credit authority are set aside for special or targeted groups of applicants, such as for non-profit sponsors or projects located in rural areas. MSHDA has its own application form and threshold requirements that must be met to submit an application, and limitations on the amount of credit a project or owner may receive, and limitations on the amount of fees an owner may include in eligible basis.

For more information on Michigan's Qualified Allocation Plan, see [Part 1070 \(Qualified Allocation Plan\)](#). A copy of the Michigan QAP for 2002 is included in [Appendix M](#).

---

**Part 220 :: The LIHTC Allocation Process**

---

In Michigan, the allocation process is made through semi-annual application rounds, with allocation criteria points given for project characteristics, such as project location and for specific commitments made, such as the income level served or special needs of residents. The highest scoring qualified projects receive reservations of tax credit. Most projects receive an allocation of credit called a Carryover Allocation in the year the application was made, prior to the construction or rehabilitation of the project. For additional information regarding the allocation process, see [Section IV \(LIHTC Allocation Basics\)](#).

---

**Part 225    IRC Section 42 Compliance and  
Monitoring Requirement**

---

The fundamental requirements for housing units with tax credits are that they must be rented only to income-qualified households and that the rents must be restricted. Household income is determined at the time tenancy begins, and is based on the actual number of persons in the household at the time of initial occupancy and the median gross income for the county in which the project is located. This is known as the “Area Median Gross Income” or “AMGI”. The rent level is also tied to the AMGI. A more detailed discussion of household income and unit rent are determined is included in **Section V (Income Limits, Rent Limits, and Utility Allowances for the LIHTC Program)**.

As of January 1, 1992, Section 42 (m)(1)(B)(iii) of the Code requires that each state’s Qualified Allocation Plan provides a procedure that the agency will follow in notifying the Internal Revenue Service (IRS) of any noncompliance with the provisions of Section 42 of which it becomes aware. Final regulations, developed by the IRS and published in September 1992, outline minimum requirements for owner record-keeping and reporting, state credit agency monitoring and inspecting, and reporting to the IRS instances of noncompliance. A copy of the compliance regulations is included in Appendix G.

Michigan’s compliance monitoring plan follows the final regulations, as well as the recommendations of the National Council of State Housing Agencies (NCSHA), and is applicable to ALL owners of ALL buildings which have ever claimed the low income housing tax credit since the inception of the program in 1987.

---

**Part 230    Compliance Period**

---

Once allocated by the housing credit agency, tax credits can be claimed annually over a ten (10) year period. All projects must, however, remain in compliance for a minimum of fifteen (15) years, with some requirements extending for an additional three years after that. The period of 15 taxable years begins with the first taxable year of a building’s credit period (the “Compliance Period”), reference Section 42(i)(1). Additionally, owners who agree in their applications to have longer compliance periods will be bound for the length of time specified.

**A.    Projects receiving Credit Allocations in 1987, 1988, and 1989 only (Pre-1990)**

Generally, properties receiving a credit allocation before January 1, 1990 have only a 15-year compliance period. However, any building in such a property that receives an additional allocation of credit after December 31, 1989, must comply with eligibility requirements in effect beginning January 1, 1990 and will be bound by a Restrictive Covenant (Revenue Ruling 92-79, provided in **Appendix H**). Projects that received credit allocations in 1987, 1988, or 1989 have building identification numbers beginning with a “87”, “88”, or “89”. For more information on building identification numbers, see **Part 970 (Building Identification Numbers)**.

## B. Projects receiving Credit Allocations after December 21, 1989 (Post-1989)

Developments with allocations of 1990 credit and after will have entered into a restrictive covenant with MSHDA at the time of final allocation. The restrictive covenant is a recorded land use agreement. These developments must comply with eligibility requirements for an additional 15 years beyond the initial 15 year compliance period (or a total of 30 years). Earlier termination of the extended use period is provided for under certain circumstances in the code see **Part 245 (Qualified Contract)**, for more information. However, if a property receives ranking points for income and rent restrictions beyond the initial 15 years, the owner will be bound by this election in the restrictive covenant.

Projects that received credit allocations after 1989 have building identification numbers that begin with digits other than “87”, “88”, or “89”. For more information on building identification numbers, see **Part 970 (Building Identification Numbers)**.

---

### **Part 235 :: IRS 8609 (Low-Income Housing Credit Allocation Certification)**

---

An IRS Form 8609 is issued by MSHDA for each building in the project that is awarded an allocation of tax credits. The form is prepared by MSHDA following completion of the new construction or rehabilitation. It identifies the amount of credit assigned to each building, the eligible basis of each building, and the low-income percentage of each building. It also indicates the placed in service date of the building.

Part I of the IRS 8609 form is completed by MSHDA and then sent to the owner when the project is placed in service and all required documentation is received by MSHDA. The issuance of the IRS Form 8609 begins the compliance period.

Part II of the IRS 8609 form must be completed by the owner for the first taxable year for which the credit is claimed. Before signing and dating Part II of the form, the owner should make sixteen (16) copies of it, one for each of the tax credit compliance years. After completion of Part II, a copy of the form is sent to the LIHTC Section of MSHDA. The original is sent to the IRS with the owner's personal, partnership, or corporate tax returns in the first taxable year in which the credit is claimed and each year thereafter in the compliance period. MSHDA will not issue an IRS Form 8609 for each year of the compliance period.

Owners should consult with their legal and / or tax advisors for advice on completing and filing the IRS tax forms. MSHDA cannot give legal or tax advice on the filing or completion of tax forms.

A sample copy of the IRS 8609 form is included in **Appendix I**. See **Part 435 (Placing an LIHTC Project in Service)** for more information.

---

**Part 240 :: Restrictive Covenant / Extended Low-Income Housing Commitment**

---

The commitments made by the owner to receive an allocation of credit are initially identified in a Carryover Allocation Agreement, and are later evidenced in a Regulatory Agreement. The Regulatory Agreement is a restrictive covenant recorded against the project, and is called an “extended use agreement” in Section 42.

The restrictive covenant binds the owner and any successors to maintain specified low-income occupancy during the extended use period. The extended use period may end on the event of foreclosure or if, during or after the 14<sup>th</sup> year of the tax credit period, the owner requests the credit agency to find a buyer willing to enter into a “qualified contract” to purchase the property and maintain its low income use for the remainder of the extended use period. For information, see **Part 245 (Qualified Contract) and Part 230 (Compliance Period)**.

Many projects, particularly those allocated in 1994 and beyond, elect to extend the number of low-income use restriction years (some into perpetuity) in order to receive additional points in the scoring process. The option of requesting the credit agency to find a purchaser is not available to owners who agreed to longer compliance periods.

MSHDA will prepare a Regulatory Agreement (Land Use Restrictive Agreement) prior to issuance of the IRS Form 8609. The document must be recorded by the owner before the end of the calendar year for which credit is first claimed. When the original recorded document is returned to MSDHDA and all fees have been paid, the IRS Form 8609 will be sent to the owner.

---

**Part 245 :: Qualified Contract**

---

A qualified contract is defined as a contract to buy the low income portion of the building for an amount no less than the applicable fraction times the sum of outstanding debt plus adjusted investor equity, plus other capital contributions, minus cash distributions. Adjusted investor equity includes those capital contributions reflected in basis – that is, not including syndication expenses – plus a cost of living adjustment not to exceed 5% annually. If no qualified contract is presented within one year after the request is made, the property may be sold or converted, subject to a three-year period during which existing low income tenants may not be evicted (except for good cause) and the rent restrictions must stay in place.

For additional perspective, see **Appendix N**, which contains the articles listed:

- “Thinking About Year 15 of a Low-Income Housing Tax-Credit Partnership”.
- “Low-Income Housing Tax Credit Partnerships: Thinking About the Year-15 Transition”.

---

## **Part 250 : Year 15 and After The Compliance Period Ends**

---

For information about requirements for the time period following year 15 of the compliance period, see IRS Revenue Ruling 92-79 (Extended-Use Commitment) and IRS Revenue Ruling 95-49 (Tenant Right to First Refusal), which are included in **Appendix H**. See **Appendix N** (Guest Article) for additional perspective.

---

## **Part 255 : Important Periods for LIHTC Projects**

---

- Tax credits can be claimed each year for a 10-year period. See **Part 440 (Credit Period)** for more information.
- The Compliance Period runs for 15 years, during which time any non-compliance with Section 42 could result in a recapture of a portion or all of the credit. See **Part 230 (Compliance Period)** for more information.
- The Extended Low-Income Housing Use Period runs 30 years, and can only be terminated earlier under special circumstances (such as when no purchaser can be located who is willing to maintain the project as low-income for the balance of the extended use period after a one-year notice period). See **Part 240 (Restrictive Covenant)** for more information.
- The Additional Low-Income Housing Use Period is a commitment to the Authority to maintain the housing for a specified period of years, which may extend beyond the Extended Low-Income Housing Use Period, with an agreement not to terminate the low-income use or Regulatory Agreement during this period. Many owners make the maximum time commitment in the allocation process. See **Section X ( Federal and State Rules, Etc.)** for more information.
- The Three-Year Period is the three years following the last of any of the above periods, during which time, no low-income tenant can be evicted except for good cause and rents must remain at the restricted level. The Three-Year Period is intended to allow a transition of use of the project following the low-income use under the program. See **Part 240 (Restrictive Covenant)** for more information.

---

## **Part 260 : Major Regulations and Legislation Impacting LIHTC Compliance Monitoring**

---

- **IRS Section 42: Low Income Housing Credit, Including Effective Dates and Related Provision** – A copy of the IRC Section 42 is included in **Appendix F**.
- **General Explanation of the Tax Reform Act of 1986 (The “Blue Book”)** – A copy of this act can be obtained at [www.irs.gov](http://www.irs.gov).
- **IRS Regulation 1.42-5 (Tax Credit Compliance Monitoring)** – A copy of the compliance monitoring regulations is included in **Appendix G**.

- **IRS Regulation (TD 8859) / 26 CFR Parts 1 and 602 (Compliance Monitoring and Miscellaneous Issues Relating to the Low Income Housing Credit)** – These regulations were issued in January 2000. A copy of the compliance monitoring regulations is included in **Appendix G**.
- **Various IRS Revenue Rulings, Revenue Procedures, and Notices:**
  - IRS Revenue Ruling 90-60, Recapture Bonds
  - IRS Revenue Ruling 90-89, Minimum Set-Aside Requirements
  - IRS Revenue Ruling 91-38, LIHTC Questions and Answers
  - IRS Revenue Ruling 92-61, Treatment of Common Area Unit
  - IRS Revenue Ruling 92-79, Extended-Use Commitment
  - IRS Revenue Ruling 94-57, Changes in Area Median Gross Income
  - IRS Revenue Ruling 95-49, Tenant Right of First Refusal
  - IRS Revenue Ruling 94-9, Number of Bedroom Method Election
  - IRS Revenue Procedure 94-57, Gross Rent Floor
  - IRS Revenue Procedure 94-64 Obtaining a Waiver of Annual Income Recertification
  - IRS Revenue Procedure 94-65, Annual Income Certification Requirement
  - IRS Notice 88-80, Determination of Income
  - Notice 88-91, Building Identification Number
  - IRS Notice 88-116, Placement in Service

See **Appendix H** (IRS Notices, Revenue rulings and Revenue Procedures) for information about obtaining IRS regulations

- **HUD Handbook 4350.3 (Section 8 Guidelines)** – An excerpt of the HUD Handbook 4350.3 is included at **Appendix D**. A copy of the entire handbook and other HUD regulations can be obtained at [www.hud.gov](http://www.hud.gov) or [www.huduser.org](http://www.huduser.org).

For more information about legislation impacting LIHTC compliance, see **Section X (Federal, State, and Local Laws and Regulations)** of this compliance manual.

For a related discussion, see Part 1080 (Interfacing LIHTC with other Government Housing Programs).